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## THE NEW BASIS OF RATE-MAKING

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I WANT to express at the outset my cordial belief in the view that the Transportation Act deserves a fair and impartial trial. Even if we were passing through times that were entirely normal, it would still be true that an act adopted with such care and after such prolonged investigation should be given a reasonable time within which to justify its usefulness. But the truth is that we have been passing through times that are wholly abnormal, and the fact that in such times a new and comprehensive piece of legislation may not have brought satisfaction to the interests affected by it is not proof that it is not a forward and constructive step. I do not know of any place in the world where any institution or any scheme of law has brought satisfaction to the people in these war years and the years since the war. So I think we must give to this new and important piece of legislation an opportunity to justify itself when we again get into something approximating normal times.

I think it is particularly important to emphasize this necessity because it is undoubtedly true that in the period of readjustment through which we have been passing, a great part of our population, and that is the agricultural part, has suffered most intensely from the unfortunate combination of pre-war prices or less for its products, and of greatly increased freight rates based on the existing much-increased costs of railroad operations.

This has been a condition which was bound to produce discontent and it was bound to direct attention to this new legislation as the most obvious reason for the trouble, although in fact, I do not believe that the legislation can be held responsible. Under any other possible scheme of legislation, we would either have had rates approximately as high as the existing rates or we would have had a series of railroad bank-

ruptcies which would have been infinitely worse for the farmers as well as the people in other walks of life.

I want to say something about the principle of rate-making which has been put into the Transportation Act. I shall not attempt again to outline the provisions of the Act on this point because Mr. Willard has done that clearly and concisely. I want to emphasize that this new rate basis has been adopted from the standpoint of the public interest and that public interest is vitally concerned in the maintenance of this new basis. The provision in the Transportation Act that rates should be so fixed as to produce a fair return upon the aggregate value of railroad property was not put there merely to provide interest and dividends for the holders of the existing bonds and stocks of the railroad companies. It was put there for other broad public purposes, in addition to that purpose, and I wish to call attention to some of these other purposes.

One aspect of the railroad business is that it employs about two million workmen. In a normal year, I suppose there would be spent by the railroads, if they have a basis of rates that yields a fair return upon their property, from two and three-quarters to three billion dollars in wages. The distribution of that amount to the wage-earners of the country would be a tremendous factor in the prosperity of every class of people in the country. But in practice there is much more fluctuation than is generally appreciated in the amount of railroad labor and the amount of the railroad pay roll. Even if the wages remain unchanged, there may be very great fluctuations in the number of employees, in the amount of work they are called on to do, and hence in the amount of money that is distributed to them as wages. The moment the railroads begin to be apprehensive as to whether they are obtaining enough revenue fairly to protect the interests with the protection of which they are charged, they begin to lay off their maintenance forces, and maintenance represents close to forty-five per cent of the total operating expenses of the railroad companies. When the maintenance employees are laid off, the purchasing power of themselves and their families is impaired and to a considerable extent destroyed, and that has a distinctly unfavorable influence upon the general state of business in the country.

The moment this condition becomes an influence to cut down general business—and the cutting down of the maintenance program is bound to have that influence—the number of freight trains begins to diminish, the number of employees in the train service is cut down, and you have an additional element which makes for a slowing down of the prosperity of the country.

Let us look now at the material which the railroads buy. I suppose it is fair to estimate that in the course of a year under approximately normal conditions, the railroads would buy from a billion eight hundred million to two billion dollars' worth of materials, which are used in the operation of the roads. In addition to this, in normal times, they would ordinarily buy perhaps two or three hundred million dollars' worth of materials for the purposes of new construction. The railroads buy nearly one-third of the soft or bituminous coal that is produced in the country. It has been estimated that they buy about forty per cent of the steel and iron articles produced in the country and that about forty per cent of the country's lumber production goes directly and indirectly into materials used by the railroads.

When the reasonable return to the railroads begins to be seriously diminished and there comes to be a cutting-down in these purchases of materials, as there is bound to be when the maintenance program is diminished, or when the construction program is diminished, we have another and very important condition to militate against the prosperity of the country. The various industries of the country, which are dependent so largely upon the railroads, commence limiting their operations, and their employees lose their jobs and their purchasing power. The volume of business diminishes still more and again we have a falling-off in the amount of freight service and in the number of trains and enginemen employed. We begin to have a cutting-down in the amount of coal that the railroads can consume, with consequent embarrassment to the coal industry and its employees.

It follows that the giving of a fair return to enable them to proceed in a normal manner with their operations has a tremendously important relation to the public interest with respect to the labor that the railroads employ, with respect to the materials that they use, and with respect to the industries which manufacture these materials, and in all these respects the gen-

eral prosperity of the country is vitally involved. When these factors take an unfavorable turn, there is no class which is more seriously affected than the farming class, which is dependent upon the general prosperity of the country in order to have a satisfactory demand for its products.

Another point of vital interest to the public is the adequacy of the railroad service. That involves two considerations: one is that the railroads of this country are not in a condition to handle satisfactorily the amount of business which could be regarded at present as normal. They need much additional equipment and many sorts of improvements in order to meet more satisfactorily the demands of the public for an adequate service. This requires capital. In addition there is a steady growth in the volume of business done in this country. In 1900 the mount of freight traffic carried was double what it was in 1890. In 1910 it was eighty per cent more than in 1900. In 1920 it was sixty per cent more than in 1910. So that we can count upon a continuing and heavy increase in the normal amount of business. I am speaking broadly now and disregarding for the moment the fluctuations that may come in particular years of depression. With this increase in traffic there must be enormous increases in the railroad plant and they cannot be obtained without enormous expenditures of money. I think Mr. Willard estimated only five hundred million dollars a year. There will be needed, I believe, eight hundred million to a billion, which can be expended in the further improvement and extension of the railroads to the distinct advantage of adequate and efficient service, although I can readily appreciate that if the railroads cannot raise that much additional money to spend, they must, and no doubt they can, by spending less than that amount, get along with a service less satisfactory than it ought to be.

Such enormous amounts of capital cannot be raised unless there is adequate assurance of a fair return to the railroads, and there again we have an important element of public interest underlying the rate-making principle of the Transportation Act.

There is still another feature embodied in this rate-making principle of the Transportation Act, and that is, that the Transportation Act was designed to establish a greater certainty as to a fair return for the railroads.

Prior to the Transportation Act, the attitude of the Government was restrictive rather than constructive. It merely told the railroads what they should not do, but assumed no obligation to aid in creating a rate basis which would affirmatively assure them a fair return. That contributed to a condition of uncertainty which was unfavorable to the public interest. The Transportation Act for the first time has imposed an affirmative, express duty on the Interstate Commerce Commission to establish a rate basis which, as far as may be, will yield a fair return. This provision was designed to establish a greater certainty, and I think that is one of the most important elements of public interest that is involved in this new conception.

I believe as the railroads become better assured of their status there can and will be developed on their part a more confident and steady policy of carrying forward on a more regular and normal basis their maintenance and construction programs. The lack of public interest in maintaining a fair return was always working to make the return uncertain. There was consequently a disposition on the part of the railroads to respond very quickly to any unfavorable aspect of general business by promptly cutting down their maintenance and construction programs. That has tremendously accentuated the tendencies already working toward depression in general business conditions, so in the past we have had a condition where this great institution, which represents the greatest organized purchasing power and the greatest organized source of wages in the country, has been under an influence which caused it, the moment there came to be signs of depression, to convert itself into an agency for increasing that depression. And that picture has another side. When business begins to get better, prices begin to go up and labor begins to get scarce, the railroads, having been forced to cut down their maintenance and construction programs in times of depression, then have to redouble their efforts in these directions and thereby they become an influence for creating instability by putting up the price, by bidding against each other and the other interests in the country, in order to make up for their deferred programs in times of depression. Further than this, the result of such a policy has been that in a time of returning general business prosperity the railroads have had to use their tracks, equip-

ment and other facilities very largely for handling their own material and supplies, which on account of their retrenchment policy during the preceding period of depression they had not purchased and distributed while they had ample surplus equipment and other facilities. This has led to congestion of business and has tended to accentuate still further the high prices characteristic of returning prosperity. I strongly believe this new policy of the Transportation Act is calculated in large part to correct these highly unfavorable influences and to enable the railroads, as they begin to feel better assured of the continuance of this new policy, to adopt a more regular policy of maintaining more uniformly in bad times their normal programs of maintenance and construction and thereby help stabilize the conditions of the whole country, rather than be forced into a condition of intensifying unfavorable influences in the direction either of further depression or of undue expansion. I think this result will be one of the most important and salutary effects of the law, and will constitute one of the most striking ways in which this new basis will be in promotion of the public interests.

I fully appreciate that the adoption of a policy of carrying forward normal programs of maintenance and construction in times of business depression involves some difficult complications in the matter of cash, because the railroad maintenance and construction work is largely a cash proposition. All employees engaged in such work must be paid in cash and all materials used in it must be bought for cash or on very short time. Naturally in time of business depression railroad companies cannot generally raise on satisfactory terms large amounts of capital by the issue of stock or of long-term bonds, and they have been quite hesitant to borrow money on short-term paper for carrying forward maintenance and construction work. Nevertheless with increased assurance of a definite and helpful governmental policy I believe the railroad companies could and ought to make further efforts than they have felt justified in making in the past to provide themselves with the necessary cash to carry forward their maintenance and construction work in times of depression when labor is more plentiful and materials are cheaper, and when they have ample equipment and other facilities for handling the work with a minimum of inter-

ference to their transportation of commercial traffic. Not only will this be to their own direct benefit, but it will immensely promote the general public interest, and hence this consideration in itself constitutes a highly important justification for the rate-making principle of the Transportation Act.

In the last analysis railroad rates will depend upon the cost at which railroad transportation can be carried on. This new rate basis rests on the assumption that this cost is a matter of vital importance. It assumes that the railroads must be economically and efficiently managed. This subject is to be increasingly a matter of scrutiny and concern on the part of the Interstate Commerce Commission. With such scrutiny, and with the efforts on the part of the railroad managements, and with the improvement of conditions generally, I think it is fair to predict that there will be such reduction in the unit cost of railroad operation that to a large extent the difficulties from which the public has suffered—and no interest has suffered more than the farmers—on account of rates out of proportion to the cost of the products transported, will be overcome. So believing as I do that this is an important forward step, and being utterly unable to think of any substitute for it which will begin to offer as great promise of adequate service, adequate employment of railroad labor, adequate consumption of materials produced in the country, or as great promise of a definite forward movement in the stabilizing of business of all sorts throughout the country, I certainly wish to add my voice in favor of giving the Transportation Act a thorough and sympathetic trial, and I predict, with great confidence, that it will justify itself when it gets normal times in which to work.